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SUBJECT: PALACIO DISAPPOINTS MANY ONE YEAR ON

Classified By: PolChief Erik Hall for reasons 1.4 (b&d)

11. (C) Summary: This week marked the one-year anniversary of Alfredo Palacio's ascension to the Presidency. He ducked the opportunity to tout the accomplishments of his first year in office or set forth a positive agenda for his remaining months. Instead, ministers were trooped before the press to defend the rather meager achievements of this government. Meanwhile, media chronicled the regime's many missteps and failures and Ecuadorian opinion-makers reached rare consensus that booting out Palacio's predecessor on April 20, 2005 had not made the situation better. The public reacted mostly with indifference, with no street mobilizations from any quarter. Trying to seize the moment, such as it was, Palacio's Government Minister lamely called for political dialogue on a national accord to boost political stability. The proposed accord is the ninth in a series of failed Palacio government attempts to promote reform or the prospect of reform. Although a good idea, the accord is unlikely to prosper. End Summary.

Few Accomplishments for Accidental President

12. (U) Media fought to outdo each other in summing up President Palacio's disappointing record during his first year in office. Politically, Palacio was held to account for failing to deliver on his promise to "re-found the republic," and for the severe instability of his Cabinet (four ministers of government, three Ministers of Economy and Finance, two Foreign Ministers, etc.). Congress and the Electoral Tribunal have already blocked eight separate attempts to promote a referendum or constituent assembly. Polls reported that 65% of respondents believed changing presidents mid-stream had not been worth it, and 82% believed the country was no better off a year later. On the economic front, Palacio was hammered for introducing the hydrocarbons law, which has put the FTA in doubt. The series of disruptive provincial strikes have extracted from the central government un-budgeted transfers to local governments. Only the successful return to the international bond market and FM Carrion's vigorous defense of sovereignty were considered advances by commentators.

Last Try at Reform

13. (U) The national accord proposal defended by Government Minister Felipe Vega consists of a proposed negotiation between political elites, the government, civil society and others to agree on a common minimum agenda that the next government could pursue without fear of being toppled mid-way

through its term. Still vague in outline, the accord would include agreements to promote rule of law, social development, sovereignty, and control over natural resources.

The proposal has been received with deafening silence by most sectors, with the exception of front-running candidate Leon Roldos, who told the press "I don't believe in consensus because there is such corruption in the economy and politics that no agreement will ever be reached."

Effect on USG Interests

14. (C) Our own accounting of the Palacio government's performance and effect on USG interests is more mixed, and somewhat moderated by our low expectations of such caretaker governments.

Positive:

-- Palacio maintained excellent cooperation against Colombian irregulars discovered in Ecuador.

-- Palacio's government also beefed up its security presence on the northern border with Colombia.

-- The GOE stepped up cooperation in the fight against narco-trafficking, dramatically increasing drug seizures and expanding cooperation on the high seas.

-- The GOE also dramatically stepped up its efforts to combat trafficking in persons.

-- Palacio permitted judicial institutions to be reconstituted without political interference, resulting in a new, more credible Supreme Court and a new Constitutional Tribunal.

-- The GOE has moved to recall high-interest bonds and replace them with lower-interest debt.

Negative:

-- Undermined from the start by his undemocratic ascent to power, Palacio overreached when promising changes he could not deliver.

-- By immediately attacking the legitimacy of Congress, and delaying the reform dialogue process, Palacio lost the limited window of opportunity that might have existed.

-- Palacio's three Ministers of Finance have maintained at least that many different, often contradictory, economic policies. Fiscal policy has deteriorated substantially, and the gutting of the Fiscal Responsibility Law damages prospects for responsible fiscal policy in the future, even after Palacio leaves office.

-- The new hydrocarbons law unilaterally modifies the contractual terms of all the significant oil companies in Ecuador, quite possibly leading to numerous arbitration cases that the GOE will likely lose, and certainly stifling investment in a sector that could be attracting billions of dollars in foreign investment.

-- Erratic policy on the free trade negotiations with the United States, including unfounded concerns by President Palacio himself on intellectual property rights issues, delayed progress at negotiations and damaged support for the agreement in Ecuador.

-- The GOE has fumbled the Oxy case repeatedly, bringing Ecuador to the verge of possible expropriation of the largest foreign investor in the country.

All Palacio's Fault?

15. (C) All Ecuadorian presidents, whether brought to power

through elections or after street action, embody citizen hopes, however fleeting, for dramatic changes to a disappointing and dysfunctional political system. Those hopes are built artificially high either by the two-round presidential election system or by the passions unleashed by street protests, fueling steep drop-offs of public support beginning shortly after assuming office. It is also worth noting that public confidence in all government institutions is extremely low (with the exception of local government, the human rights ombudsman, and the Armed Forces). Palacio's approval ratings (around 15%, down from a high of 59% upon taking office), have dipped below even those of the president of Congress.

¶6. (C) In addition to complicating governance, this cycle often causes embattled presidents, blamed by the media and public for perceived failures, to launch public relations counter-offensives and populist initiatives, often under the sway of opportunistic sycophants intent on defending their president. This phenomenon led to Gutierrez' downfall, and may today be centralizing policy-making in the office of Palacio's powerful Secretary of Public Administration, Jose Modesto Apolo, recently elevated to primacy and Cabinet rank.

Looking Ahead

¶7. (C) Ironically, the more ineffective and marginal the Palacio government becomes, the more assured it is of reaching the end of its term. Indigenous anti-FTA protesters are still regrouping, and hopeful an accord is never reached.

While no longer at great risk of being toppled, we are entering a particularly sensitive period for USG interests. Powerless to impose its own vision, and in a vain search for legitimacy, this government is prone to offering populist proposals that run counter to USG interests, such as the recently approved hydrocarbon law or a possible negative ruling on the Occidental Petroleum dispute.

¶8. (C) On the democracy front, the national accord is not a bad idea and could conceivably help promote greater democratic stability for the next government. But coming from an unpopular government without allies, and during the run-up to a presidential campaign, it is very unlikely to prosper. Chances for bridge-building among Ecuador's atomized political elites always increase after the first round of presidential ballots, when the remaining two candidates have an incentive to craft a program to attract the also-rans and thereby emerge with a working alliance in Congress. Nevertheless, Palacio will not even be represented in that election, so even if a "pact" is put in place, it won't be his.

¶9. (C) USG trade interests, set back in the short run, could possibly improve under the next government which takes office in January 2007. We are already noting a change in Ecuadorian perceptions of the issue, which had been portrayed by ideological opponents as a USG imposition. Instead, Ecuadorians are now increasingly hearing from those whose interests will be hurt without an FTA.

¶10. (C) We need to continue to engage with Palacio and his ministers to salvage and protect USG interests, while simultaneously preparing the ground for more productive relations with his successor. Beyond simply assuring that elections in October and November are free, fair and inclusive; and engaging early with presidential contenders; the latter must also include measures to strengthen democratic stability, to help break the vicious cycle Ecuador's president's face on taking office.

¶11. (C) We share an interest in democratic stability with Ecuadorians of goodwill, but also with other members of the international donor community. We intend to engage fully with these nations and international institutions to promote joint vigilance and coordination, and possibly joint statements or other actions, to encourage political dialogue

and stabilizing political reforms.
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